A REVALUATION OF TRADITIONAL ECONOMIC THEORY

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The title of this paper is not to be taken too seriously. What I have to say might be better described by some such title as "Obsolete and obsolescent problems of economic theory." I am using the term "traditional" in a limited sense and am directing attention not so much to the earlier or classical tradition as to more recent developments most of which do not go back so far as John Stuart Mill.

My own generation of economists found itself born into a very stimulating intellectual environment. Spirited controversies were going on among the ablest economists with regard to some of the very foundations of economic science. And there was also radical scepticism, which repudiated all comprehensive thinking and devoted its constructive effort altogether to the study of miscellaneous particulars. The situation was both confused and confusing. Intellectual orientation was difficult to the last degree.

Speaking as one member of my own generation, I believe that we are at last beginning to find our bearings. We are beginning to see our way ahead and to recognize amongst us the definite unfolding of a common scientific purpose. I shall try to present as clearly as I can one formulation of this purpose, in order to explain, in part, why any of us has the assurance to designate as obsolescent certain problems of general theory with which we at one time found ourselves absorbed.

An eminent European economist, writing seventeen years ago, ascribed the confusion to which I have referred to our general preoccupation with the theory of value.[1] He declared in so many words that "the most radical and effective cure for this confusion would be to do away with the whole theory of value" and to begin at once with "an explanation of *prices* and the general causes governing them." He held this procedure to be quite possible and wholly advantageous. The thesis which at that time sounded so radical has since become almost commonplace. Seven years ago the man now President of this Association, after a devastating criticism of traditional definitions of economics, published his ringing declaration that economics "treats phenomena from the standpoint of price."[2] Another eminent American economist, now a man of international eminence, writing about nine years ago, pointed out some extremely serious "limitations of the value concept,"[3]

1 G. Cassel, *The Nature and Necessity of Interest,* (London and New York: Macmillan, 1903), pp. 68-69.

2 H. J. Davenport, *The Economics of Enterprise* (New York: Macmillan. 1913).

3 Allyn A. Young, "Some Limitations of the Value Concept," *Quarterly Journal of Economics,* vol. 25, (May, 1911), pp. 409-28.

and so helped to remove the theory of value from current consideration and to relegate it to its proper place in the history of economic doctrines. Still another American economist, distinguished alike in the fields of economics and statistics, speaking before this Association five years ago, traced with approval "the tendency to make the use of money the central feature of economic analysis," and advanced cogent reasons for expecting the development of this tendency to broaden the scope and to enrich the content of economic theory.[4] The general point of view indicated by these references may be designated as the catallactic point of view. As its meaning comes to be more fully appreciated, the confusion which came down from earlier generations and enveloped us for so long is being gradually dispelled.

The full description of the catallactic point of view cannot be put into a sentence. But its meaning is somewhat precisely indicated by saying that the central task of economics is to study the causes and the effects of the rise and fall of prices—taken both one by one and as related in groups—with the purpose of forecasting their future and possibly controlling their movement. In this formulation, of course, the prices referred to are market prices and they include many things, such as rates of interest and wages, which are not called prices in the language of the street. And the formula is somewhat unsatisfactory in several other respects: It makes no explicit mention of incomes, especially profits; it involves no specific reference to the institution of the market and the technical processes of marketing; and it fails to call sharp attention to the social, ethical, and political motives which alone make the task outlined seem to some of us worth while. But anyone who has worked with this formula, following any problem suggested by it through whatever concrete facts of human nature and the social order turn out to be both relevant and essential, will testify to the enthusiasm which such work engenders. With respect to the one central question about prices and markets, in all its aspects, economists, as I believe, are coming to look upon themselves and to be looked upon as genuine experts, qualified to meet the challenge of all other experts and of the public at large. They are coming to see more and more clearly why this is the one special and expert capacity in which they *must* participate in the advancement of human welfare, and to feel less and less acutely the obligation to speak with any special authority, as economists, upon matters irrelevant to their central question, however fully these other matters may still be treated in textbooks of the traditional type.

Recent developments in the field of social philosophy have clarified

[4] W. C. Mitchell, "The Rôle of Money in Economic Theory," American Economic Review, Supplement, vol. VI (Mar., 1916).

our understanding of the relations between human nature and the social order. Social psychologists, for instance, have done much to increase our appreciation of the organic nature of society and to show that human nature, as we know it today, is the product of institutional development reacting upon those impulses and aptitudes which came down to us from our animal ancestors. Thus human nature or human personality serves to integrate the institutions which make up the social order and these institutions in turn are indispensable to the integration of human personality. Among the institutions involved are the family, the church, the state, and various social classes each of which is identified by its community of interest in some specialized phase of the social process. One such institution is the market, which is like all the others in being inspired to some degree by human nature, in exercising its own influence upon human nature, and in penetrating and being penetrated by all the other institutions which make up the social order. My view of the function of the economist is largely determined by the results of this analysis. He is not primarily concerned with the interpretation of human nature as a whole, nor primarily concerned with the study of the social order as a whole, nor yet responsible for the development of any comprehensive science of human behavior. His primary business is to discover the truth about the institution of the market. Economics studies the market as political science studies the state. Appreciation of this analysis seems to me to be fundamental to the catallactic point of view.[5]

One feature of this point of view, likely to appeal most strongly to economists who have the greatest confidence in human intelligence and intellectual power, is its promise of integration and unification. For a full appreciation of it will bring all of us, to the extent that we pose as general economists, to interpret the institution of the market as a whole, and the intricate interlocking price system as a whole, while it brings each of us, to the extent of his special professional qualifications, to interpret the institution in some one of its parts, such as the money market, the market for coal, the field of railway rates, or the labor market. When such appreciation becomes general, if it ever does, we shall probably witness the disappearance of those traditional distinctions, practically genuine enough but never scientifically satisfactory, between the topics of production, exchange, distribution, and consumption, which have for a hundred years been almost standard practice in the textbooks. We shall also demonstrate that there is no sharp contrast between pure theory and applied theory. Who shall say, for

[5] See especially the three works of Professor Charles H. Cooley: *Human Nature and the Social Order* (New York: Scribner's, 1902); *Social Organization* (New York: Scribner's, 1909); *Social Process* (New York: Scribner's, 1918).

instance, whether work on the rate of interest, designed to make possible more accurate forecasts in respect to impending movements in that rate and more intelligent control over these movements, falls in the one field or the other? Most of the older work in the theory of prices has been done with reference to ideal or hypothetical prices in ideal or hypothetical markets. These markets are liquid markets in which there is, literally by hypothesis, a tendency toward the establishment of a single price at which the rate of demand is made equivalent to the rate of supply and vice versa. Such a market, literally by hypothesis, "tends toward equilibrium." But there are no actual markets in which a single price prevails; even in the money market, the most liquid of all actual markets, we find, at present, rates of interest which vary in different parts of the world from perhaps 4½ per cent to 12 or 15 per cent or even more. The money market, then, is not altogether liquid. No other market, however, is nearly so liquid as the money market, and most markets are very far indeed from being liquid markets. If we are to understand prices in these other markets we must study these other markets as they are, collecting the essential facts about each one and interpreting these facts. Both the work of description and the work of interpretation will be helped along by checking the organization of each market against the organization of that perfect or liquid market which the older economic theory has been accustomed to study, but I venture to believe that nothing more is to be learned about perfectly liquid markets. We are at last fully equipped to study actual markets. As we proceed, then, to do so, as dictated by acceptance of the catallactic point of view, we shall be giving to our general subject a degree of unity, precision, and timeliness which will enable economics to sit among the other sciences without an uneasy conscience, and will give to the great body of economists coherence and power beyond anything that the profession has known for a full century.

The accomplishment of our common task, as here outlined, has little or no need for any abstruse theory of value. Realization of this fact comes home to most of us, steeped as we have been in value theory, with some surprise. But the truth seems to be that we are dropping the term value from our vocabularies—except as we refer to market values or appraised values, made definitely intelligible by reference to market prices, either in some actual market or in some such market modified in specified direction and degree. Our procedure in this respect follows rather closely the usage of business men; it differs from that usage chiefly in that we make more distinctions and finer distinctions, such as the one between what the market value has been, as a matter of historical fact, or is now under given circumstances of time and place, and what the market value *ought to be* in view of some legitimate require-

ment of social progress or public policy. Economists who work, for instance, on the practical problem of evaluating the property of a public utility, say for purposes of rate-making, and who realize explicitly just what they are about, afford one of the most striking instances of the newer procedure.[6] Great confusion results, however, from the attempt sometimes made to consider prices as reflecting exchange relations as they are, and values as indicating exchange relations as they ought to be. The distinction we really need is that between what the market price or market value is, on the one hand, and what the market price or market value ought to be, on the other. This distinction emphasizes the importance of the great range of ethical and moral considerations with which we, in common with all other social scientists, must become familiar in order to preserve our intellectual and moral integrity, to avoid using our technical knowledge and skill in the service of powers that prey, and to direct our effort in public affairs along truly progressive lines.

If some more general theory of value were needed anywhere, we might suppose it would be most needed when we come to treat the value of money. We continue, of course, to speak of the value of money, but the catallactic meaning we give to this expression, while somewhat abstract, is neither abstruse nor vague. "We mean the purchasing power of money as reported or expressed by the money prices of other things."[7] And we say, without mincing matters, that "there is no such thing as 'the general purchasing power of money,'" because neither any human being nor any social group either buys or sells, at any price, on the market, any such thing as a certain quantity of things-in-general. So money has in reality not one value but many values, a million indicated by the price quotations for a million different articles in almost as many markets, and a thousand for as many different groups of selected articles entering into the purchases or sales of selected families, business firms, and social groups. The values of money rise and fall, in all of these relations, as the prices concerned fall and rise; the causes involved are the same causes and the consequences are one and the same. Thus the theory of money, of the value of money, comes to be incorporated in the general theory of prices, where it forms one of the most difficult, interesting, and promising problems. No one anywhere, or at any time, so far as I am aware, has ever said that this problem belongs to anybody but economists; it is a typi-

[6] See for instance remarks of Joseph Mayer, American Society of Civil Engineers, *Transactions*, 1915. Vol. 79, pp. 177-89.

[7] R. T. Ely, *Outlines of Economics* (New York: Macmillan, 1916), p. 317. This is the third revision of Professor Ely's *Outlines*. The reference is to a part of the book for which Professor Young was presumably responsible.

cal and characteristic problem. And no economist, if I may say so, has ever been helped toward its solution by starting his investigation on the basis of some general theory of value, particularly any theory of value which rested upon marginal utility or upon marginal disutility or upon some combination of the two. The really promising results have been obtained by work done on the history of price changes and on the scientific explanation of that history.

Our analysis now begins, then, with the immediate observation of market price and not, as formerly, with "the inscrutable depths of the private mind."[8] It no longer proceeds from desire to utility, from utility to marginal utility, from marginal utility to subjective value, from subjective value to objective value or exchange value, then from exchange value to price and finally from price in general to market price. Utility and disutility, diminishing utility and increasing disutility, the utility curve once supposed to be back of market demand and the disutility curve once supposed to be back of market supply, marginal utility and marginal disutility—all these belong to that list of topics in which we were once deeply interested, but in which we are becoming less interested with every passing year. Along with them are departing all the other members of the utility family, such as marginal desirability and marginal significance, sub-marginal and extra-marginal utility and disutility, producers' surplus and consumers' surplus, social surplus and social deficit. All theories of value involving the hedonistic calculus, in short, are in process of complete disappearance from the consciousness of constructive workers in economic theory. It is no part of my present intention to specify in detail the shortcomings of these theories of value, but I will venture to make one sweeping generalization: To the extent that economists have been so strongly obsessed by the hedonistic calculus, they have placed in the foreground of investigation problems so phrased and so conceived as to make impossible both the appeal to history and the statistical attack.

In respect to the great problem of distribution a thoroughgoing renovation of traditional apparatus is in process. The problem retains all its passionate interest, but no longer seems to stand out by itself. There is nothing peculiar about such prices as the rent of land per acre per annum, wages per day per man, interest per annum per dollar and the like, and the respective markets in which these prices prevail, to any economist who has come to look upon the interpretation of all prices and all markets as the one great problem of general economics. The income problem, that of determining the reasons why individuals, business firms, and classes in society have so much or so little of salable things to sell in these markets at these prices, is part of the solution

[8] Cooley, *Social Process*, p. 297.

of that one great problem. Little or no light is shed upon it, as we are coming to realize, by those theories of value and of distribution which involve the marginal productivity analysis.

We are beginning to see that the marginal productivity theory—apart from certain ethical implications explicitly repudiated by careful productivity theorists—has never contributed much to an understanding of distribution. Its general meaning can perhaps be summed up in one comprehensive formulation. Free enterprise, operating in open markets, tends to carry the substitution of measurable quantities of every factor for measurable quantities of every other factor to the point at which a dollar's worth of each, as valued on the open market, will accomplish the same mechanical result as a dollar's worth of every other. Formulated in this way, the marginal productivity theory of distribution can be seen to be nothing more than a refined elaboration of the law of single price in liquid hypothetical markets. All the work of studying actual markets remains to be done. And if we suspect this formulation of superficiality, and seek to "go behind" it in search for whatever additional meaning the theory possesses in the minds of its particular friends, we discover that the marginal productivity theory of distribution, resting at bottom upon the hedonistic calculus, asserts that the marginal disutilities involved in production correspond, after some fashion, with the marginal utilities involved in distribution and consumption. As to this apparently more refined formulation two observations are in order: First, it is incapable of statistical verification because of the fact that utilities and disutilities are not measurable magnitudes. Secondly, the more refined formulation is not one bit more profound than the other; it is in fact quite as meaningless as any other application of the hedonistic calculus.

We do more than suspect, therefore, that the marginal productivity theory of distribution is an explanation which does not do much to explain "why some of us are much better off and others much worse off than the average."[9] Some of the most competent of its friendly expositors indeed say quite frankly that "the principle of marginal productivity is an illuminating way of stating the problem of the distribution of wealth, rather than a solution of it."[10] And they go on to note that the purpose of the analysis of diminishing productivity is "to open the way for a discussion of the prices paid for the services of land, labor, and capital."[11] Economists who have formed the habit of looking into markets, prices, and the great intricate interlocking price system, in all the concreteness with which these surround us, are dis-

[9] Edwin Cannan, *Wealth* (London: King. 1914).

[10] Ely, Third Edition, p. 400.

[11] *Ibid.*, p. 394.

posed to doubt the degree of the "illumination" and to wonder why "the way" to so obvious a task needs to be so very thoroughly prepared. The way is now open, in any case, so that we may feel quite free to proceed, without further preliminary, with our study of prices and incomes, searching out all those persistent historical and social influences—beneficent, malevolent, or neutral—which have determined and continue to determine the amounts of salable things which different individuals and classes are in a position to sell or to buy at these prices.

Let me present one more crucial instance, the problem of the so-called business cycle, arising naturally in all minds which contemplate those alternating periods of prosperity and depression, good times and bad times, which have become so profoundly significant during the last hundred years. This is another of those problems which has always been conceded to economists by common consent. The public looks to them both for an explanation of why such things occur and for constructive suggestions looking toward their prevention and mitigation. The challenge presented by this problem is unescapable, and an increasing amount of scientific work is being devoted to it. Business barometers, so-called, indices of general business conditions, the correlation of statistical series of a hundred kinds are being worked upon, analyzed, interpreted, and used for purposes of forecast and control. Those who have aptitude for this great problem, and who have once felt its fascination, cannot be drawn away from it; they feel its intellectual charm, and they know how much its correct solution means to the welfare of humanity. In many respects it is the primary problem of our time, and there is no other problem, be it noted, which cuts so sharply and so unmistakably across the traditional divisions of production, exchange, distribution, and consumption.

Yet how little attention is given to this problem in current textbooks on the principles of economics. How little, in fact, has been contributed to the solution of this problem by that whole body of effort which was centered about the theory of value, and interested in distilling the relative amounts of truth in the marginal utility theory and the marginal disutility theory. And the reason is not far to seek. The problem of the business cycle is a social problem, the phenomena of antecedence and consequence are social phenomena, whereas the preoccupations of several generations of economists have been individualistic. They could use no such thing as social marginal utility or social marginal disutility, for there are no such things; such shadows of shades afforded no means of attack upon social problems, such as the problem of crises and depressions. The root of this problem is surely in the price system, and can be arrived at only by going into the history of crises, which means the history of modern society—and the value theorists

never found any genuine place in their analysis for the history of anything. Even historical chapters used as introduction to textbooks on principles of economics were little more than patchwork, for they were seldom referred to in any other part of the book.

We need to know what profits have been, how they have been made, to what uses they have been put, and the effects upon human nature and the social order of the profit-making motive: no light on these matters is shed by the analyses of value, of utility and disutility, that have preoccupied so many of us for so long.

The bewildering period into which my own generation of economists was born seems to have been blessed with a noble scientific heritage, but one that was already in process of thoroughgoing regeneration. Magnificent critical work has now been done on that heritage and painstaking intellectual experiment, based on certain traditional methods of attack, has measurably demonstrated the inadequacy of those particular methods. The way to constructive work has meanwhile become more and more evident, and there seems to me every reason to believe that the scientific outlook for the next ten or twenty years is highly encouraging. A most encouraging feature of that outlook, in my judgment, is a growing disposition amongst us to recognize the obsolescent character of some of the questions with which we have ourselves but recently been wrestling and to call them by their right name. They belong to that group of questions found now and then in the history of science and philosophy "which are settled, if at all, not by being decided one way or the other, but by becoming obsolete."[12]

[12] Cooley, *Human Nature and the Social Order*, p. 19.